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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 236

IDAHO POWER COMPANY,
Petitioner,

v.

THE UNITED STATES,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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IDAHO POWER COMPANY,
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THE UNITED STATES,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Idaho Power Company, your petitioner, respectfully prays that a Writ of Certiorari be issued to review the order and judgment of the United States Court of Claims dismissing its petition to that Court.

Opinion Below

The opinion and findings of fact of the United States Court of Claims in petitioner's case are printed in Appendix A hereto, *infra*, pp. 1a-22a, and are reported at 161 F. Supp. 807. The judgment of the Court of Claims is based, in part, upon its decision in *Atlantic City Electric Co.* v. *United States*, decided the same day. The opinion of the Court of Claims in *Atlantic City Electric Co.* v. *United States*, is printed in Appendix B hereto, *infra*, pp. 1b-12b, and is reported at 161 F. Supp. 811.

Jurisdiction

The order and judgment of the United States Court of Claims was entered on May 7, 1958 (*infra*, Appendix A hereto, p. 7a). The jurisdiction of this Court is invoked under the provisions of 28 United States Code, Section 1255.

Questions Presented

(1) Whether a cash distribution of earnings and profits of $8 per share made to holders of petitioner's 7% and $6 preferred stock upon exchange of said stock for petitioner's new 4% preferred stock, pursuant to a recapitalization, constituted a dividend for purposes of computing petitioner's dividends paid credit under Section 26(h) of the Internal Revenue Code of 1939.

(2) Whether a cash distribution of earnings and profits of $10 per share made to holders of petitioner's 7% and $6 preferred stock upon cash redemption of said stock constituted a dividend for purposes of computing petitioner's dividends paid credit under Section 26(h) of the Internal Revenue Code of 1939.

Statutes Involved

The statute involved in this case is the Internal Revenue Code of 1939 as applicable to the year 1944 (26 U.S.C. 1940 ed.). All references to Code sections hereinafter will be to the 1939 Internal Revenue Code unless otherwise noted. The specific sections of the Internal Revenue Code of 1939 which are controlling in this case are set out in Appendix C hereto, *infra*, pp. 1c-6c.

Statement

Idaho Power Company, petitioner herein, brought an action against the United States in the United States Court of Claims to recover income and excess profits taxes in the amount of $91,145.80, a part of the taxes paid by it for the year 1944. The jurisdiction of the United States Court of Claims is based on Title 28, United States Code, Section 1491, which grants jurisdiction to render judgment upon any claim against the United States founded upon any Act of Congress.

The petitioner, Idaho Power Company, is a Maine corporation, with its principal office and place of business in Boise, Idaho. It is, and in 1944 was, a public utility as defined in Section 26(h) of the Internal Revenue Code.

On June 23, 1944, the stockholders of petitioner met and approved a plan which provided for a recapitalization of petitioner's capital structure.

Prior to June 23, 1944, petitioner's Certificate of Organization provided for the issuance of 450,000 shares of common stock with a par value of $20 per share, 50,000 shares of preferred stock with a par value of $100 per share and 50,000 shares of $6 preferred stock with no par value. The $100 par value preferred stock carried a dividend rate of 7%. Both classes of said preferred stock will be sometimes referred to hereinafter as "old preferred stock".

As a result of the stockholders' approval of the plan of recapitalization on June 23, 1944, petitioner's Certificate of Organization was amended on said date to provide that on and after August 1, 1944 the number of shares of capital stock which could be issued by petitioner would be 550,000 shares divided into 100,000 shares of preferred stock with a par value of $100 per share, and 450,000 shares of common stock with a par value of $20 per share.

This preferred stock was to carry a dividend rate of 4%, and will be sometimes referred to hereinafter as "new preferred stock".

The aforesaid plan of recapitalization provided that petitioner would exchange and replace its 7% and $6 preferred stock for new 4% preferred stock on the basis of one share of old preferred stock for one share of new preferred stock plus accumulated dividends payable on August 1, 1944, plus a cash payment of $8 per share. Under this plan, all old preferred stock not so exchanged by July 22, 1944 was to be redeemed on August 1, 1944 at the rate of $110 per share (the redemption price of the old preferred stock set by petitioner's by-laws) plus the final quarterly dividend which was payable on August 1, 1944. Pursuant to an agreement with three underwriting firms, the shares of new preferred stock which were not exchanged for shares of old preferred, were to be purchased by said underwriters on August 1, 1944 and offered for sale to the public.

Immediately prior to August 1, 1944 petitioner had outstanding 28,457 shares of $6 preferred stock and 32,130 shares of 7% preferred stock. This stock was issued prior to October 1, 1942 and constituted preferred stock as defined in Section 26(h) of the Internal Revenue Code (*infra*, Appendix C, p. 1c).

Pursuant to the plan of recapitalization, holders of 20,354 shares of the $6 preferred stock and holders of 19,233 shares of the 7% preferred stock turned in their old preferred stock and received in exchange therefor, during 1944, an aggregate of 39,587 shares of petitioner's 4% preferred stock, together with a cash payment at the rate of $8 per share in a total amount of $316,696, which amount was charged on the books of the petitioner to earned surplus.

Holders of 21,000 shares of the old preferred stock did not exchange said shares for the new 4% preferred stock of petitioner and, in accordance with the plan of recapitalization, this old preferred stock was redeemed on August 1, 1944 at $110 per share by an aggregate payment to the holders thereof, of $2,310,000. Ten dollars per share of the $110 per share redemption price represented redemption premium.

The total capital paid in when the old preferred stock was issued was $100 per share. The total premium of $210,000 paid by petitioner on August 1, 1944 in connection with the redemption of its old preferred stock was charged to earned surplus on the books of petitioner.

At the end of 1944 petitioner's accumulated earnings and profits after Federal and State income and excess profits taxes but before any distributions thereof to stockholders during 1944 amounted to $1,234,075.32. Total distributions to stockholders (common and preferred) during 1944 (including the aforesaid exchange and redemption premiums) amounted to $1,604,022.00.

Total distributions solely in respect of petitioner's preferred shares including the aforesaid exchange and redemption premiums amounted to $884,022.

In its Federal income tax return for the year 1944, petitioner did not claim or receive any dividends paid credit under Section 26(h) of the Internal Revenue Code for the cash distribution of $316,626 paid out of earnings and profits to the stockholders who exchanged their stock or for the amount of $210,000 in redemption premium paid out of earnings and profits to the stockholders who redeemed their stock.

In a claim for refund duly filed with the Commissioner of Internal Revenue and in discussions and hearings before representatives of the Commissioner of Internal

Revenue, petitioner claimed that the premiums paid in connection with the exchange and redemption of its old preferred shares constituted a dividend for purposes of computing its dividends paid credit under Section 26(h) of the Internal Revenue Code.

Petitioner's contentions were formally rejected by the Commissioner and this action was duly commenced in the Court of Claims.

On May 7, 1958, the Court of Claims held against the petitioner on the grounds (1) that the exchange premiums did not have "the effect of the distribution of a taxable dividend" and (2) the redemption premiums were not "dividends" within the meaning of Section 26(h).*

On the same date the Court of Claims also rendered an opinion in *Atlantic City Electric Company* v. *United States*, 161 F. Supp. 811, and entered an order and judgment in *General Public Utilities Corporation* v. *United States*. No opinion was written in the *General Public Utilities Corporation* case. The issue in the *Atlantic City Electric Company* and *General Public Utilities Corporation* cases is the same as the issue in petitioner's case with respect to whether the cash premium payment to those shareholders whose 7% and $6 preferred stocks were redeemed constituted a dividend for the purposes of the dividends paid credit provisions of Section 26(h). The *Atlantic City Electric Company* case contains the reasoning of the Court of Claims on the redemption premium point. The Court's opinion there was applied to disposition of this issue in petitioner's case but was not repeated in its opinion in petitioner's case. It is petitioner's under-

* The Government raised certain other issues which the Court below did not consider, relating to adequacy of petitioner's earnings and profits, allocation of the exchange and redemption premium distributions and sufficiency of petitioner's refund claim as to the redemption premium.

standing that both *Atlantic City Electric Company* and *General Public Utilities Corporation* are planning to file with this Court Petitions for Writs of Certiorari to the United States Court of Claims in their cases.

The issue in petitioner's case pertaining to the exchange premium was not involved in either the *Atlantic City Electric Company* or *General Public Utilities Corporation* cases.

REASONS FOR GRANTING THE WRIT

I

The decision of the United States Court of Claims below pertaining to the exchange premium issue is in conflict with a prior decision of this Court and decisions of other federal courts on a basic question which is important to the administration of the federal revenue acts.

II

An important question of federal law is involved as to the redemption premium which has not been, but should be, settled by this Court.

I

The decision of the United States Court of Claims pertaining to the exchange premium issue is in conflict with a prior decision of this Court and decisions of other federal courts on a basic question which is important to the administration of the federal revenue acts.

This Court, in *Commissioner of Internal Revenue* v. *Estate of Bedford*, 325 U. S. 283 (1945), held that a cash distribution paid out of earnings and profits by a corporation to a shareholder in connection with a recapitalization, whereunder shares of old preferred stock were exchanged

for new preferred and common stock, constituted a dividend. Petitioner submits that there is a conflict between this Court's decision in *Estate of Bedford* and the decision in petitioner's case by the Court of Claims.

The *Estate of Bedford* case, while involving the Revenue Act of 1936 (49 Stat. 1648), covers precisely the same statutory provisions with respect to dividends as are involved in the present case. In *Estate of Bedford* the taxpayer, in connection with a recapitalization of Abercrombie & Fitch Company, exchanged 3,000 shares of cumulative preferred stock (par value $100) for 3,500 shares of cumulative preferred stock (par value $75), 1,500 shares of common stock (par value $1.00) and $45,240 in cash. The sole question in the case was whether the $45,240 was taxable to the recipient as a dividend or as a capital gain, it being conceded that the recapitalization was a reorganization and that Section 112(c) of the 1936 Revenue Act was applicable.

The *Estate of Bedford* case and petitioner's case are striking in their similarity:

First, in both cases there was a recapitalization constituting a reorganization under the tax law.

Second, in both cases old preferred stock was turned into the issuing corporation in exchange for new preferred stock.

Third, in both cases cash was paid out of earnings and profits to the shareholder making the exchange at a specified amount per share.

Fourth, in both cases the issue was whether the cash paid to the exchanging shareholders was a distribution taxable as a dividend.

Fifth, in both cases identical statutory provisions had application.

Notwithstanding that *Commissioner of Internal Revenue* v. *Estate of Bedford, supra,* and the petitioner's case are entirely parallel, the Court of Claims, in petitioner's case, reached a conclusion which, petitioner submits, is in direct conflict with the decision of this Court in *Estate of Bedford.*

In *Estate of Bedford* the precise question was whether the distribution of cash in the recapitalization there had "the effect of the distribution of a taxable dividend" under Section 112(c)(2) of the Revenue Act of 1936 (49 Stat. 1648, 1680). This is the same question in petitioner's case under identical provisions of Section 112 (c)(2) of the Internal Revenue Code (*infra,* Appendix C, p. 3c).

In *Estate of Bedford* earnings and profits were available for distribution of dividends which exceeded the amount of cash distributed in connection with the recapitalization reorganization exchange. This Court found that the cash distribution, being paid out of earnings and profits, necessarily must be considered a taxable dividend within the definition of that term in Section 115(a) (*infra,* Appendix C, p. 4c). Section 115(a) as applied in *Estate of Bedford* and as applicable in petitioner's case provides that "The term dividend when used in this chapter * * * means any distribution made by a corporation to its shareholders out of earnings and profits * * *" (Omitted matter not here material).

In response to the Government's argument in *Estate of Bedford* that the distribution there in issue more nearly had the effect of a "partial liquidation" within the meaning of other subsections of Section 115 with resultant capital gains treatment, this Court held (325 U. S. 291-292):

> "The definition of a 'partial liquidation' in Section 115(i) is specifically limited to use in Section 115. To attempt to carry it over to Section 112 would distort its purpose. That limitation is not true of Section 115(a) which defines 'dividend' for the purpose of the whole title. Accordingly, this definition is infused into Section 112(c)(2). Under Section 115(a) a distribution out of accumulated earnings and profits is a 'dividend' thus confirming the conclusion that a distribution of earnings and profits has the 'effect of a distribution of a taxable dividend' under Section 112(c)(2)."

Thus this Court has recognized that a "dividend" as required by the definition in Section 115(a) comprehends *any* distribution out of earnings and profits and that such definition by specific statutory terms is infused into Section 112(c)(2) and must be so applied in respect of distributions falling within the latter section. Furthermore this Court emphasized in *Estate of Bedford* that Section 115(a) defines the term "dividend" "for the purpose of the whole title". Therefore the definition of a dividend, as contained in Section 115(a) would be applicable to the term "dividends paid" in Section 26(h) which is a part of the title (or chapter as used in the 1939 Code) referred to in *Estate of Bedford*. Under Section 26(h) the dividends paid credit here in issue is quite simply stated: "In the case of a public utility, the amount of dividends paid during the taxable year on its preferred stock:" (*infra*, Appendix C, p. 1c.)

In the opinion in *Estate of Bedford* this Court cited numerous Court of Appeals and Tax Court decisions which support the proposition that a distribution from earnings and profits in connection with a reorganization has the effect of a distribution of a taxable dividend under Section 112(c)(2). (325 U. S. 291.). The decisions subsequent

to the *Estate of Bedford* decision have also consistently taken this view. *Hackinson* v. *Commissioner of Internal Revenue*, 235 F. 2d 747 (2d Cir. 1956); *Becher* v. *Commissioner of Internal Revenue*, 221 F. 2d 252 (2d Cir. 1955); *Sheldon* v. *Commissioner of Internal Revenue*, 6 T.C. 510 (1946).

Furthermore this Court reiterated its *Estate of Bedford* conclusion in its subsequent decision in *Bazley* v. *Commissioner of Internal Revenue*, 331 U. S. 737 (1947), 332 U. S. 752 (1947), where a distribution of earnings and profits occurred through the issuance of debentures together with new stock in exchange for old stock. The earnings and profits of the issuing corporation were sufficient to cover the value of the debentures. While the issue was decided on other grounds this Court stated categorically that if the facts therein spelled out a reorganization, the receipt of debentures in connection with the recapitalization exchange therein involved would be taxable under Section 112(c)(1) and (2), citing *Estate of Bedford*.

That the Court of Claims decision in petitioner's case is in conflict with this Court's decision in *Estate of Bedford* is quite clear.

In *Estate of Bedford*, as we have shown, this Court applied the tax statute according to its terms after having found as a fact that the cash distribution (colloquially referred to as "boot") was made out of earnings and profits. Such fact established the distribution as having "the effect of the distribution of a taxable dividend". The ultimate fact of the existence of earnings and profits was found controlling. The decision applies no other tests. If this Court had considered the fact of earnings and profits of itself as not sufficient to establish the "effect" of a taxable dividend it most assuredly would have been

constrained to so state since otherwise its decision would have been patently incomplete. This Court's findings as succinctly written by Mr. Justice Frankfurter are complete and wholly dispositive of the issue.

The Court of Claims in rejecting application of *Estate of Bedford* to petitioner's case does so first by stating "If Congress meant merely to say that any boot money at all paid out of earnings should be a taxable dividend, it used a verbose and complicated way of saying it" (*infra*, Appendix A, p. 4a), and then by undertaking an extensive showing that there was no "dividend equivalence" in the petitioner's cash distribution (*infra*, Appendix A, pp. 5a-7a).

As to the Court of Claims first point, the language employed by Congress is, of course, quite clear and wholly in keeping with the necessary pattern of the statutory provisions of which it is a part.

As to the "dividend equivalence" test, we search in vain in the *Estate of Bedford* opinion for such a test. Certainly if this Court, having found the distribution in *Estate of Bedford* as one out of earnings and profits and as such a dividend, had also determined that such fact was not enough, that a further "dividend equivalence" must be found, it would not have left such an essential element to be read into the decision by subtle implication.

While the *Estate of Bedford* case involved the tax position of the dividend recipient, if under Section 112(c)(2) the distribution "has the effect of a distribution of a taxable dividend" in the hands of the recipient shareholder, necessarily, and by definition in Section 115(a) as construed in *Estate of Bedford*, it must be deemed a dividend paid as to the distributing corporation and as such a "dividend paid" within the meaning of Section 26(h). In fact the precise position here urged has been upheld

repeatedly by the Tax Court. *Weingarten, Inc.* v. *Commissioner of Internal Revenue*, 44 B.T.A. 798 (Acq. 1944 C.B. 24); *Hartman-Tobacco Company* v. *Commissioner of Internal Revenue*, 45 B.T.A. 311 (1941) (Acq., 1943 C.B. 11); *Knapp Monarch Co.* v. *Commissioner of Internal Revenue*, 1 T.C. 59 (1942) (Acq., 1943 C.B. 14), *aff'd*, 139 F. 2d 863 (8th Cir. 1944). Each of these cases involved a claim by the corporate distributor for a dividends paid credit in respect of a cash distribution made as part of a reorganization exchange of stock.

In so far as the record of prior cases shows, the Government has long and consistently maintained the position so vigorously and successfully urged by it in *Estate of Bedford*. Moreover, as recently as 1956 the Commissioner of Internal Revenue in *Revenue Ruling 56-220*, 1956-1 C.B. 191, cited and relied on *Estate of Bedford* in ruling that where a statutory merger was consummated under Section 368(a)(1)(A) of the 1954 Internal Revenue Code, cash distributed out of earnings and profits to the shareholders of the absorbed or merged corporation, upon exchange of stock in the merged corporation for stock in the surviving corporation, had the effect of a distribution of a dividend and was so taxable in the hands of the recipient shareholder who exchanged his stock. Significantly no mention of the "dividend equivalence" factor was made in the ruling. Undoubtedly the Commissioner's steadfast stand has been motivated, and quite properly, by fiscal considerations since dividends as a tax source are substantially more lucrative than capital gains, and it seems strange indeed that in petitioner's case we are confronted with a sudden reversal of that position.

If the decision of the Court of Claims in petitioner's case is left standing, a new principle thereby would be evolved requiring the application of subjective tests in

ascertainment of the fact of intent to distribute a taxable dividend. No such subjective tests or intent are stated in this Court's decision in *Estate of Bedford*, nor do we find any such requirements in the statute.

It is clear therefore that not only is the decision of the Court of Claims in petitioner's case in direct conflict with the decision of this Court in *Estate of Bedford* but the Court of Claims decision now creates confusion in a field of tax law which heretofore had been well settled by reason of the clear statutory provisions of Section 115(a) and the equally clear decision of this Court in *Estate of Bedford*.

The position here urged by petitioner does no violence to the fundamental philosophy of the taxing act. The exchanging shareholders here continued as shareholders in the same corporation; there was no liquidation or shrinkage of the corporate business; the capital interest of the shareholders remained the same albeit their contractual rights under this interest were somewhat altered. The Court below seemed to find this alteration of such significance that somehow these continuing shareholders no longer retained their previous "status". This, of course, is error. Their "status" was and remained that of preferred stockholders. For the alterations in their preferred stock contract, they received their *quid pro quo*, to wit: a distribution strictly within the terms of their contractual rights, and since the distribution was out of earnings and profits *ipso facto* and by statutory definition it must be a dividend. That it may or may not actually have been taxed as such to the recipient shareholder, petitioner submits, is an irrelevant administrative matter.

The fact, as mentioned by the Court below, that the petitioner's common shareholders may have benefited from the reorganization, is equally irrelevant.

The significant question here of course does not concern the position or effect upon the common shareholder but is: What happened to the preferred shareholders? The answer is that they were and continued to be preferred shareholders, their original capital interest in the corporation continuing and in no wit impaired. This, we believe, is the essence of this Court's decision in *Estate of Bedford*. The continuing shareholder received a corporate distribution of earnings and profits; hence, he received a dividend in a very real as well as statutory sense. As applied here this means the petitioner paid a dividend which is a "dividend paid" under Section 26(h).

The taxable status of corporate distributions is of course of primary importance to both corporate distributors and the recipients of such distributions. This Court recognized this fact in *Estate of Bedford* by stating that certiorari was granted in that case on a showing of importance to the administration of the revenue acts (325 U. S. 289). Thus while there is present a direct conflict between a decision of this Court and a decision of the Court of Claims sufficient to support a granting of a Writ of Certiorari in this case, there is also present a question which is important to the administration of the revenue acts, as acknowledged by this Court in *Estate of Bedford*.

II

An important question of federal law is involved as to the redemption premium which has not been, but should be, settled by this Court.

In the Court of Claims, Atlantic City Electric Company, General Public Utilities Corporation and petitioner presented virtually the same issue pertaining to the question

whether the redemption premiums constituted dividends for the purpose of Section 26(h). The reasoning of the Court of Claims on the redemption premium point as applicable to all three cases is contained in the *Atlantic City Electric Company* decision (*infra*, Appendix B, pp. 1b-12b).

A. The question presented is one of importance which has never been decided by this Court.

Section 26(h) of the 1939 Internal Revenue Code is now Section 247 of the 1954 Internal Revenue Code. The question therefore is not peculiar to the 1939 Code, but continues under the 1954 Code.

The Court of Claims' decision in petitioner's case and its decisions in the companion cases of *Atlantic City Electric Company* and *General Public Utilities Corporation* on the redemption premium and the exchange premium issue* definitely create uncertainty as to the law in the important area dealing with the tax status of corporate distributions.

The Court below described its view of the statutory situation in dealing with the redemption premium issue in the *Atlantic City Electric Company* opinion where, after analyzing certain statutory provisions deemed relevant, the Court stated (*infra*, Appendix B, p. 6b):

> "The foregoing summary shows that the statutory situation is confused."

Again, in the same opinion, the pervading doubt of the Court as to the proper solution of the problem presented is indicated by the statement (*infra*, Appendix B, p. 12b):

> "As our discussion has indicated, Section 115, and other legislation relating to analogous situations, give rise to conflicting inferences."

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* Only petitioner's case involves the exchange premium issue.

The dilemma of the Court is further expressed in the Court's statement (*infra*, Appendix B, p. 12b):

> "Our instant problem has not been decided by any court."

Thereupon the Court below makes a general but uncited reference to decisions of this Court and other courts which have adjudicated related problems and then states it recognizes that the results in those decisions could have been reached without the use of language as inclusive as that used by the courts in such decisions, further stating however that it could not ignore these expressions of opinion (*infra*, Appendix B, p. 12b).

Finally, the Court below in *Atlantic City Electric Company* refers to "the question being so evenly balanced" and reiterates that the "* * * instant problem has not been decided by any court" (*infra*, Appendix B, p. 12b).

Petitioner submits that these expressions of indetermination, doubt and uncertainty in the opinion below leave the important question presented by petitioner's case and its companion cases not only unresolved but surround the principles they involve with an aura of confusion and indecision. Petitioner believes that the indicated statements convey virtually a request by the Court of Claims to this Court to resolve the questions and to clarify the controlling law.

While the tax status of corporate distributions, of course, is of major importance to the over-all administration of the internal revenue laws as affecting taxpayers generally, the issue here involved particularly affects the tax position of every public utility corporation which has preferred stock outstanding upon which deductions or credits may be claimed for dividends paid. As mentioned in the Petition for Writ Certiorari filed by General Public

Utilities Corporation, a survey of preferred stocks of public utilities which would apparently qualify under Section 26(h)* and its successor provision, Section 247 of the 1954 Internal Revenue Code, discloses that, apart from stock which may be issued in the future to refund bonds, there are outstanding at least 235 issues of preferred stock of public utility companies operating in all states which may give rise to the question here presented. In fact, one public utility corporation, Kentucky Utilities Company, has already filed suit on this issue in the District Court for the District of Kentucky. Also, your petitioner is aware of at least two other public utilities which have this issue currently pending before the Internal Revenue Service awaiting disposition of this issue by this Court and of two additional public utility companies which are confronted with the same issue in a proposed refund claim. The pervasive importance of the questions here presented thus is evident.

In light of the demonstrated importance of this issue it is appropriate to point out specifically the errors of the Court below.

B. The Decision of the Court of Claims is Incorrect.

1. A distribution in liquidation may be deemed a dividend distribution by the corporation in the ordinary meaning of that term to the extent that it includes a distribution of the corporation's earnings and profits.

The *Atlantic City Electric Company* decision viewed in its entirety and apart from its specific statutory analyses seems to say that if a distribution in liquidation is to be

* See Sinclair-Murray Capital Changes Reporter, distributed by Commerce Clearing House, Inc., Vol. 3, pp. 6501-6542.

considered by the recipient as tantamount to a sale of the stock, it must be considered by the corporate distributor as a purchase of stock; hence, in such a situation there can be no dividend distribution as to the distributor.

In this context both sides of the transaction are given solely a capital effect and any inherent earnings aspect is ignored. But the query then is: Can the earnings aspect of the matter be ignored as to the distributor if in fact there is an earnings distribution even though the recipient may be in position of receiving solely a return of his capital investment? We urge that the earnings aspect cannot properly be disregarded where the facts show that the liquidation distribution involves not only a return of capital by the distributor corporation but also a distribution of earnings by the corporate distributor. A distribution of earnings from the corporate standpoint is synonymous with distribution of a dividend.

To say that a liquidation distribution is tantamount to a "purchase" by the corporation of its own stock, in effect equates the transaction with the purchase of an investment. There may be occasions where a corporation may purchase its own stock for investment purposes, but where, as here, the transaction is considered in the nature of a partial liquidation and the stock is cancelled and retired, it is difficult to discern any investment characteristic in the transaction.

These general observations are intended to give point and background to the analysis which follows and which we believe clearly shows the errors in the opinion of the Court below.

2. The motivating purposes of the statute are met when all distributions on qualified preferred stock of a public utility out of earnings and profits are allowed as a credit for dividends paid.

At the very outset of its opinion the Court below in *Atlantic City Electric Company* recognized the basic statutory intent in the treatment, for purposes of the tax statute, of public utility preferred stocks as similar to corporate indebtedness, citing its decision in *Public Service Electric and Gas Co.* v. *United States*, 157 F. Supp. 846 (1958). However, toward the conclusion of its opinion in *Atlantic City Electric Company* the Court sharply limits this analogy in respect of the credits or deductions allowable to "normal recurring payments which all persons would recognize as dividends" (*infra*, Appendix B, pp. 11b-12b). The clear inference is that the preferred stock-corporate indebtedness analogy applies only in allowing recurring dividends as deductions as akin to the deduction allowed for interest on indebtedness. This sharp limitation, we urge, is error.

The emphasis in the Congressional hearings at the time Section 26(h) became part of the tax statute was upon the similarity of utility preferred stocks and corporate debt under the circumstances governing the issuance of such stocks.* Nowhere is found any suggestion that the similarity be limited to the interest deduction aspect of corporate indebtedness.

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* *Hearings before Committee on Ways and Means on Revenue Revision of 1942*, 77th Cong., 2nd Sess. 199-206, 3327-3331, 3334-3343 (1942); *Hearings before Committee on Finance on H. R. 7378* (Revenue Act of 1942), 77th Cong., 2nd Sess. 159-164, 1839-1851, 1859-1873 (1942); *Hearings before Committee on Ways and Means on Revenue Revision of 1943*, 78th Cong., 1st Sess. 1338-1348, 1445 (1943).

Initially the Section 26(h) credit was limited to preferred stocks outstanding on October 1, 1942.

When, in the Revenue Act of 1943 (58 Stat. 21), preferred stocks issued subsequent to October 1, 1942 to refund public utility indebtedness outstanding on that date were allowed the same credit, the intended total analogy between the two types of securities attained full significance.

Finally Section 26(h) itself contains no such limitation as the Court below suggested. The statute in respect of the credit does not read as it might have read (had Congress so intended): "regular recurring dividends paid" —it simply reads "dividends paid" (*infra*, Appendix C, p. 1c).

Thus, as here, when the dividend distribution upon call and redemption of the preferred stock may be compared with the premium paid upon the call and redemption of indebtedness, the purpose of the statute is fully implemented by allowing the stock redemption premium as a deduction precisely as the debt redemption premium is similarly allowed. Treasury Regulations 111, Sec. 29.22(a)-17(2)(b); Treasury Regulations 118, Sec. 39.22(a)-17(b).

3. The fact that by statute a liquidation distribution is treated as to the recipient as payment in exchange for the stock does not require that part of such distribution may not be considered as a dividend by the distributor.

The Court below in *Atlantic City Electric Company* carefully reviewed the Government's argument there to the effect that if Section 115(c) (*infra*, Appendix C, p. 5c) of the tax statute requires a liquidation distribution to be treated by the *distributee* as payment in exchange for the

stock (as it does), the distributor corporation must be considered as having purchased the stock, which would preclude any deduction under Section 26(h). The Court further noted the Government's argument that a reading of Section 115(c) as applying only to the distributee-shareholder would be "illogical and asymmetrical". After further analysis the Court stated (*infra*, Appendix B, p. 5b):

> "We are not persuaded, then, by the Government's argument for symmetry in the interpretation of Section 115(c)."

Nevertheless upon further examination of the opinion and the Court's conclusion, there remains, as we see it, no other basis for the Court's position except the concept of "symmetry".

Furthermore the Court in the opinion in petitioner's case (decided simultaneously with that of *Atlantic City Electric Company*) directly contradicts its statement in the *Atlantic City Electric Company* case quoted above by stating (*infra*, Appendix A, p. 3a):

> "The Government argued successfully in *Atlantic City Electric Company, supra*, that if the payment was not a dividend received in the hands of the distributee-shareholder, it was not a dividend-paid as regards the distributor-corporation."

Under the indicated circumstances it is difficult for petitioner to state what the position of the Court below really is in respect of the "symmetry" principle urged by the Government but if, as we believe, it has adopted that principle, petitioner submits for reasons already stated, and those stated below, it is in error.

4. The definition of the term "dividend" in Section 115(a) applies to that term as found in Section 26(h) and it is error to find that it is modified by the provisions of Section 115(c) as applied to a dividend distribution as to the corporate distributor.

The Government has relied heavily on the partial liquidation provisions of Section 115(c) in undertaking to show that these provisions so apply to a distributor corporation as to prevent the full application of the dividend credit definition of Section 115(a) in interpretation of the term "dividends paid" found in Section 26(h).

The Court below in the *Atlantic City Electric* opinion considers this argument specifically in respect of the first three sentences in Section 115(c) which it involves.

The first sentence requires that a distribution in liquidation shall not be treated as a dividend but shall be treated as payment in purchase price of the liquidated stock. The Court notes that this sentence does not specifically indicate whether such payments are to be so treated as to the distributee shareholder as well as the distributor corporation or only as regards one of them. We believe this view is in error since under a reading of the section with its purpose in mind, it is quite clear that the language can apply only to the distributee. The purpose of the language, of course, is to accord by statute to the liquidating transaction in the hands of a distributee the characteristics of a sale, when a sale in fact has not taken place, so as to bring into play the statutory scheme for treatment of capital gains and losses under Section 117 upon sale or exchange of a capital asset. Since the capital gain and loss provisions have no application to the corporate distributor, and since for the reasons as

stated above, it would be an obvious distortion to consider that the distribution in partial liquidation is equivalent to a purchase of the stock by the corporation, the indicated sentence clearly is without meaning as to the distributor corporation.

The second sentence of Section 115(c) concededly applies only to the distributee shareholder.

The third sentence refers to the treatment of the distribution by the corporate distributor in respect of capital account or of earnings or profits. Prior to the Revenue Act of 1936 this sentence specifically was stated as applicable to the corporate distributor. The Revenue Act of 1936 dropped the "purpose" language, but the Commissioner's Regulations* under this sentence of the statute continued the explanation of its purpose and, of course, these Regulations under the indicated circumstances have the force and effect of the law. The quite obvious intention of the sentence is that a distribution involving a pay-out of earnings and profits shall be so applied by the distributing corporation for all purposes including, petitioner submits, that of a dividend distribution.

Notwithstanding the evident clarity of the statute under analysis the Court below found that its summary in respect of Section 115(c) shows that "the statutory situation is confused" (*infra*, Appendix B, p. 6b).

Petitioner respectfully submits that the Court's inconclusive interpretation of Section 115(c) not only is error, but apparently it contributed to its ultimate decision, since that decision can only be construed as an adoption of the Government's position as to the preventive effect of Section 115(c) upon the dividend definition in Section

* Treasury Regulations 94, Art. 115-5; Treasury Regulations 103, Sec. 19.115-5(c); Treasury Regulations 111, Sec. 29.115-5.

115(a) as applied to the "dividends paid" credit in Section 26(h), and this we urge is the fundamental error of the Court below in this case.

This Court, in *Estate of Bedford*, had under consideration a virtually identical argument which urged that the partial liquidation provisions of Section 115 necessarily limited the pervasive application of the dividend definition as found in Section 115(a). This Court dismissed the argument by stating that the partial liquidation provisions are specifically limited to use in Section 115 and cannot be carried over to another section of the law, noting that such limitation is not true of Section 115(a) which defines the term dividend for the purpose of the whole income tax chapter, and by further pointing out that such definition of a dividend is "infused" into other sections of the law where the term is used (325 U. S. 291-292). In *Estate of Bedford*, it was infused into Section 112(c)(2). Here, it is infused into Section 26(h).

Therefore, not only in principle, but in contravention of the specific edict of this Court, it clearly appears that the Court below was in error in accepting the proposition that the partial liquidation provisions of Section 115(c) must be applied in modification of Section 115(a) in the prevention of the application of the dividend definition to the term "dividends paid" as found in Section 26(h).

5. The fact that the statutory term "dividends paid" as found in Section 26(h) was not modified by statute to comprehend liquidation distributions does not prevent application thereto of the "dividend" definition found in Section 115(a).

The $210,000 redemption premium payment made by petitioner was not a distribution which was properly chargeable to capital account under Section 115(c) and

therefore must have been a distribution from earnings and profits under Section 115(a). As petitioner has stated, Section 115(a) defines a dividend "*when used in this chapter*" as "*any* distribution made by a corporation to its shareholders * * * out of the earnings or profits * * *." (Emphasis added.) Since the redemption premium payment is a distribution out of earnings and profits, petitioner submits that it is a dividend as to petitioner within the definition of that term in Section 115(a) and as such is allowable as a credit under Section 26(b). This Court in *Commissioner* v. *Estate of Bedford*, *supra*, particularly emphasized that the term "dividend" is defined in Section 115(a) "for the purpose of the whole title" (325 U. S. 292).

The Court below in the *Atlantic City Electric Company* opinion undertook to examine the application of Section 115(a) as here urged from the standpoint of the distributing corporation. In so doing it considered the statutory situation in the taxing of undistributed profits which the Court seemed to view as comparable with that in the case before it (*infra*, Appendix B, p. 9b).

For the purpose of compelling the distribution of corporate profits so that they could be taxed in the hands of the shareholders, Congress, in Section 14 of the Revenue Act of 1936 (49 Stat. 1648), imposed on corporations a surtax on their undistributed corporate profits. Undistributed profits were determined after allowing a credit for dividends paid, and in the section which ultimately became Section 27(g) of the Internal Revenue Code of 1939, Congress provided a credit against the undistributed corporate profits for that part of a distribution in liquidation which was "properly chargeable to earnings and profits accumulated after February 28, 1913". The section provided such payments to the indicated extent should be "treated as a taxable dividend paid."

The Government, in petitioner's case and its companion cases, argued to the effect that if Section 115(c) must be construed as limited to the status of liquidation distributions in the hands of the distributee, there would have been no reason for the insertion of Section 27(g) in the Code, since the general definition of a dividend in Section 115(a) would accord for undistributed profits tax purposes a dividend paid credit for the portion of a liquidation distribution considered paid out of earnings and profits. The Government reasoned from the premise that if liquidating distributions were to be comprehended within Section 26(h) the Congress would have specifically so provided as it did in Section 27(g) (*infra*, Appendix B, p. 9b).

Petitioner submits however that there is a difference of controlling significance, between defining a dividend as in Section 27(g) as a distribution

> "properly chargeable to earnings and profits accumulated after February 28, 1913"

and defining a dividend as in Section 115(a) as

> "any distribution * * * (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

The significance of the difference in the definition is that Section 27(g) was concerned with distributions in liquidation from the corporate payor's viewpoint and the Congress refused to allow a deduction in respect of the undistributed profits tax of a dividend paid, where in fact, the corporate distributor in liquidation, although having cur-

rent earnings and profits but no *accumulated* earnings and profits was therefore in position to make only a capital distribution. *Cf. St. Louis Co. v. United States*, 237 F. 2d 151 (3rd Cir. 1956), *cert. denied*, 352 U. S. 1001. In contrast Section 115(a) by its terms views as a dividend paid *any* distribution either out of post-1913 earnings or current year earnings without regard to accumulated earnings. This definition is modified only, as we have shown, by the treatment of liquidating distributions *solely as to the distributee.*

The Court below in *Atlantic City Electric Company* said there is force in the Government's Section 27(g) argument (*infra*, Appendix B, p. 9b). But the error of this argument is clearly apparent since as shown, and contrary to the basic premise of the Government's argument, there is a very real difference between the dividend definition in Section 115(a) and Section 27(g). Furthermore it can be argued, of course, that omission from this statute of a modification of the "dividends paid" term in Section 26(h) is just as significant from the petitioner's viewpoint as the Government claims from its viewpoint. Notwithstanding the Court's apparent acceptance of the Government's argument on this point, somewhat later in its opinion, and seemingly in keeping with the contradictory climate of the entire opinion, the Court referred to another comparative statutory situation in another instance of a "dividends paid" credit. The Court discussed a section of a 1935 Act* which became Section 121 of the Internal Revenue Code of 1939, which gave to banks and domestic insurance companies a tax deduction for dividends paid on their preferred stock. The Court in its opinion duly noted that the Secretary of the Treasury

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*Act of Aug. 27, 1935, Public Law 374, 74th Cong. 1st Sess., Ch. 767, Sec. 3; 49 Stat. 908.

had suggested that the bare language in the draft of the bill, *i.e.*, "any dividend paid" should be qualified by the parenthetical expression "(not including any distribution in liquidation)" and that the change was made. The Court of Claims thereupon noted specifically (*infra*, Appendix B, p. 11b):

> "It is fair to urge that the change was made because the general language 'any dividend paid' would have, without the qualification, included distributions made in liquidation, according to the definition of dividends in Section 115(a)."

We submit that this phase of the Court of Claims' decision gives added force to the necessity of a review thereof by this Court.

CONCLUSION

The writ of certiorari to the United States Court of Claims should be granted.

Respectfully submitted,

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July, 1958.

Appendix A

Decision of The United States Court of Claims and Opinion of Madden, J.

In the United States Court of Claims

No. 208-55

(Decided May 7, 1958)

IDAHO POWER COMPANY v. THE UNITED STATES

OPINION

MADDEN, *Judge*, delivered the opinion of the court:

The plaintiff corporation sues to recover $91,145.80 of income and excess profits taxes, a part of the taxes paid by it for the year 1944. The ground for its suit is that it was denied a "dividends paid" credit or reduction of its taxable income, which reduction it claimed on account of certain payments made by it in connection with the rearrangement of the structure of its preferred stock.

The plaintiff is a public utility. Its contentions in this suit are, in part, the same as those made by the Atlantic City Electric Company, whose case was this day decided. —— C. Cls. ——, No. 33-55, decided May 7, 1958. We will not repeat here the background material which is recited at length in the *Atlantic City Electric Company* case.

The plaintiff's preferred stock met the qualifications prescribed in section 26 (h) of the Internal Revenue Code of 1939 to make the dividends on that stock eligible for

the tax deduction provided for in that section. In 1944 it had outstanding common stock and two classes of preferred stock, one class being 7 percent stock and the other, in effect, 6 percent stock. Both classes of preferred stock were callable by the corporation at $110 per share plus accrued dividends. The corporation called the preferred stock by offering the stockholders the choice of either exchanging their stock, share for share, for new 4 percent preferred stock plus $8 per share in cash, plus accrued dividends, or surrendering their stock for $110 per share in cash, plus accrued dividends. At this time 88 percent of the preferred stock was owned by persons who did not own any common stock.

Some two thirds of the shares of preferred stock were exchanged for the new 4 percent preferred stock and the cash. The other one third were redeemed for the $110 per share in cash.

As to the payments made for the redemption of preferred stock, the plaintiff's situation is like that of the taxpayer in *Atlantic City Electric Company, supra*, and our conclusion is that the plaintiff's payments were not "dividends" within the meaning of section 26 (h).

The plaintiff claims that the "boot money," the $8 per share which was paid to the holders of the 6 percent and 7 percent shares which were exchanged for the new 4 percent stock, was a dividend within the meaning of section 26 (h) for reasons which vary somewhat from those urged in support of the claim relating to the redeemed stock. It points to section 112 (c) of the Internal Revenue Code of 1939 which says, in effect, that in an otherwise tax-free exchange of property by a corporation, in a reorganization transaction, if there is boot money paid, and if the

payment "has the effect of the distribution of a taxable dividend," then the boot money should be taxed to the distributee as a dividend, i.e., as ordinary income and not as capital gain.

It will be remembered that section 115 (c) provides that distributions in liquidation shall be treated as payments for the stock liquidated and not as taxable ordinary income. The Government argued successfully in *Atlantic City Electric Company, supra*, that if the payment was not a dividend received in the hands of the distributee-shareholder, it was not a dividend-paid as regards the distributor-corporation. By comparable reasoning, it would seem that, in the case of a reorganization covered by section 112 (c), if the boot payment is such that it is treated as a taxable dividend in the hands of the distributee, it should be a tax deduction for the distributor.

We consider, then, whether the $8 payment had "the effect of the distribution of a taxable dividend," within the meaning of section 112 (c) (2). Section 115 (g) has a comparable provision for redemption situations. It says:

> If a corporation cancels or redeems its stock * * * at such time and in such manner as to make the distribution and cancellation or redemption * * * essentially equivalent to the distribution of a taxable dividend * * *

the distribution shall be treated as a taxable dividend.

Both of these provisions have the purpose of preventing the distribution, under the guise of a liquidation or a reorganization, of what are in effect dividends and giving the distribution the favorable tax status of a capital gain transaction.

The plaintiff says that all that is required to bring the distribution within the coverage of section 112 (c) (2) is that there should be an exchange of stock and the payment of boot money. It says that the existence of these two facts produces the legal conclusion that the boot money was a taxable dividend to the stockholder, and a tax deduction to the corporation; that the statutorily required equivalence follows, *ipso facto*. It urges that *Commissioner* v. *Estate of Bedford*, 325 U. S. 283, so holds.

The text of section 112 (c) seems to us to contradict the plaintiff's contention. Paragraph (1) of the section treats of an exchange of stock which would be tax free except for the payment of boot money, and provides that if the boot money represents a gain to the shareholder, the gain should be taxable as such. Then paragraph (2), on which the plaintiff relies, provides that if the exchange would otherwise be within the provisions of paragraph (1), "but has the effect of the distribution of a taxable dividend," then the boot money should be taxed to the distributee as a dividend, to the extent that it is paid out of earnings and profits. If Congress meant merely to say that any boot money at all paid out of earnings should be a taxable dividend, it used a verbose and complicated way of saying it.

The plaintiff says that the Supreme Court of the United States in *Commissioner* v. *Estate of Bedford*, *supra*, held what we are urged to hold. In that case it was quite plain that the cash payment made in connection with the exchange was made to get around a New York statute which prevented the corporation from avowedly paying a dividend. There were other circumstances indicating that the payment was the distribution of a dividend under another

guise. The Court's opinion did not emphasize the facts showing equivalence, but we do not read the decision, as the plaintiff does, as making equivalence in fact legally irrelevant.

This court, in *Stein* v. *United States*, 104 C. Cls. 446, recited the particular facts showing that the payment was equivalent to a dividend, and in *Smith* v. *United States*, 131 C. Cls. 748, it recited the facts showing that the payment was not so equivalent. In *Rheinstrom* v. *Conner*, 125 F. 2d 790 (C. A. 6), the court analyzes numerous cases in which courts have determined, on the facts of each case, the question of equivalence. We think we must do so in this case.

In the litigation over the application of section 112 (c) (2) and the comparable section 115 (g), distributee-taxpayers have sought to convince the courts that the distribution was not the equivalent of a dividend. The Government has urged the contrary. On the other hand, corporation-distributors have urged that the distributions were dividends, in order to get the tax credit granted by section 26 (h) to public utility corporations, or by section 27 to corporations charged with unreasonably accumulating surplus, and corporations whose stock is closely held. In the section 26 (h) and section 27 cases, the Government has sometimes not contested very vigorously the allowance of the dividends-paid credit to the corporation if it could be sure that the payments had been taxed to the shareholders as dividends.

The test of whether the payment is the equivalent of a dividend is the same in the case of a corporation which seeks an affirmative response as in the case of a shareholder who seeks a negative response.

Appendix A

In the instant case, as we have seen, the holders of the 6 and 7 percent preferred stock were given the option of redemption at $110 or exchange for 4 percent, $100 par new issue preferred stock. Some 40,000 shares were exchanged and some 20,000 redeemed. At the time of the redemption and exchange, 88 percent of the old preferred stock was owned by persons who did not own any common stock of the corporation, of which there were 450,000 shares of $20 par value outstanding. There had been authorized, but unissued, some 40,000 additional shares of preferred stock which the corporation had the power to issue at any time. In the process of reorganization the by-laws were amended so that the unissued shares could not be issued except upon a majority vote of the common stock and a majority of the preferred stock, unless certain specified conditions were met.

An important indicium of equivalence of a payment to a dividend is present if, after the exchange of stock and the payment, the shareholder still has the same or substantially the same interest in the corporation after the payment that he had before. The ordinary dividend received by a shareholder does not disturb his interest in the corporation at all. He has the right, in the future, to the same fixed rate of dividend on his preferred stock, or the same share of the profits, on his common stock, as he had before the dividend was paid. In the instant case the shareholders' status, for the future, was drastically changed. His rate of return upon his stock was reduced from 7 percent or 6 percent to 4 percent, a reduction of 42 percent or 33⅓ percent. It is not conceivable that one holding such shares in this prosperous corporation, with its preferred stock dividends all paid up to date,

would have made such an exchange for a boot of $8 except under the compulsion that otherwise his stock would be redeemed at $110. This last figure was, in fact, less than the market price of the shares had been before the redemption action was initiated.

The reorganization was for the benefit of the common stockholders who were, as we have seen, almost entirely different persons from those who held the preferred stock. In the solicitation of proxies for the stockholders' meeting to authorize the redemption of the preferred stock, the president of the plaintiff stated that the proposed action would result in a saving to the corporation, after taxes, of $128,775 per year. The reorganization also made an important increase in the voting power of the common stock, by requiring its separate concurrence in the future issuing of the unissued shares of preferred stock.

We think that the payment of money here in question, made in the course of a reorganization which so severely reduced the interest of the shareholders in the corporation, did not have "the effect of the distribution of a taxable dividend" within the meaning of section 112 (c) (2).

The Government has raised a question as to the adequacy of the plaintiff's claim for refund as to the redemption premium and a question as to the sufficiency of earnings and profits to cover all the distributions made in 1944. Both of these questions are interesting and, probably, difficult. In view of our conclusion as to the question treated at length in the opinion, we need not resolve them.

The plaintiff's petition will be dismissed.

It is so ordered.

LARAMORE, *Judge*; WHITAKER, *Judge*; LITTLETON, *Judge*; and JONES, *Chief Judge*, concur.

Appendix A

FINDINGS OF FACT

The court, having considered the evidence, the stipulations of the parties, the briefs and arguments of counsel, makes findings of fact as follows:

1. The action arises under the Internal Revenue laws of the United States and more particularly Section 26 (h) of the Internal Revenue Code of 1939.

2. The jurisdiction of this Court is based upon Title 28, United State Code, Section 1491, in that this is a claim against the United States founded upon an Act of Congress.

3. No action upon the claim, other than as set forth in these findings, has been taken by plaintiff before the Congress or any of the departments of the United States or in any court and no assignment or transfer of said claim has been made by plaintiff.

4. At all times hereinafter mentioned plaintiff was, and now is, a corporation duly organized and existing under and by virtue of the laws of the State of Maine, and having its principal office and place of business in Boise, Idaho.

5. Plaintiff is now and in 1944 was a public utility, as defined in Section 26 (h) of the Internal Revenue Code of 1939, engaged in the sale of electric energy in the States of Idaho, Oregon and Nevada; under rates in Idaho which have been established or approved by the Idaho Public Utilities Commission; under rates in Oregon which have been approved by the Public Utilities Commission of Oregon; under rates in Nevada which have been approved by the Public Service Commission of Nevada and under

rates approved by the Federal Power Commission with reference to sales of power for resale in interstate commerce.

6. On or about March 29, 1945, plaintiff, pursuant to a grant of extension of time, duly filed its Federal income tax return for the calendar year 1944 with the Collector of Internal Revenue for the District of Idaho. Net income of $2,347,849.72 for the calendar year 1944 was reported on said return which indicated an income tax liability of $582,246.96. Said income tax liability was paid to the Collector of Internal Revenue, for the District of Idaho in installments as follows:

March 30, 1945	$145,750.00
June 19, 1945	145,373.48
September 14, 1945	145,561.74
December 17, 1945	145,561.74

7. On or about March 29, 1945, plaintiff, pursuant to a grant of extension of time, filed its Federal excess profits tax return for the calendar year 1944 with the Collector of Internal Revenue for the District of Idaho. Net income of $2,347,849.72 for the calendar year 1944 was reported on said return which indicated an excess profits tax liability of $711,836.83. In said return, plaintiff claimed, and was allowed by the Commissioner of Internal Revenue in a Notice of Adjustment dated October 6, 1945, an abatement of its 1944 excess profits tax in the amount of 10% or $71,183.68. This abatement arose as a result of the 10% credit against the excess profits tax as provided under Section 784 (a) of the Internal Revenue Code of 1939. Plaintiff's excess profits tax liability for the year 1944, after application of such credit, amounted to

$640,653.15. Said excess profits tax liability was paid to the Collector of Internal Revenue for the District of Idaho in installments as follows:

March 30, 1945	$180,000.00
June 19, 1945	175,918.42
September 14, 1945	142,367.37
December 17, 1945	142,367.36

8. On or about May 27, 1946, plaintiff received a refund of income taxes for the year 1944 in the amount of $986.44 and a refund of excess profits taxes for the same year in the amount of $436,424.12. These refunds were allowed as a result of an Application for Tentative Carryback Adjustment filed on or about March 12, 1946 pursuant to Section 3779 of the Internal Revenue Code of 1939 with respect to amortization of emergency facilities on an accelerated basis under Section 124 (d) of the Internal Revenue Code of 1939.

9. On or about March 18, 1947, plaintiff filed with the Internal Revenue Agent in Charge, Salt Lake City, Utah, a Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment (Form 874). In said waiver, plaintiff accepted an overassessment in income taxes for the year 1944 in the amount of $5,331.40 and consented to the assessment and collection of $15,017.73 in excess profits tax for the year.

10. On March 25, 1948, within the period of limitation prescribed by Section 322 (b) of the Internal Revenue Code of 1939, plaintiff filed with the Collector of Internal Revenue for the District of Idaho a Claim for Refund of Federal income and excess profits taxes paid for the calendar year 1944. In said claim, plaintiff demanded refund

of $50,079.74 in Federal income taxes and $4,725.14 in excess profits taxes for said year. On July 7, 1953, the Commissioner of Internal Revenue, by registered mail, sent to plaintiff a notice of disallowance of said claim.

11(a). Immediately prior to August 1, 1944, plaintiff had outstanding 450,000 shares of Common Stock of a par value of $20 per share, 28,457 shares of $6 Preferred Stock and 32,130 shares of 7% Preferred Stock, both classes of Preferred Stock sometimes being referred to hereinafter as "old Preferred Stock." Said old Preferred Stock was issued prior to October 1, 1942, and constituted preferred stock as defined in Section 26 (h) of the Internal Revenue Code of 1939.

11(b). Immediately prior to August 1, 1944, both the old Preferred Stock and the Common Stock were publicly held. One hundred and twenty-four persons or corporations owning a total of 9.248% of the Common Stock also owned, in varying proportions, 7,300 shares of the outstanding 60,587 shares of both classes of old Preferred Stock. The remaining 53,287 shares of old Preferred Stock were widely distributed among persons or corporations who did not own any Common Stock. The old Preferred Stock holdings of the one hundred and twenty-four persons or corporations referred to above bore no consistent percentage relationship to their Common Stock holdings.

12. On June 23, 1944, plaintiff's Certificate of Organization was amended to provide that on and after August 1, 1944 the number of shares of capital stock that may be issued by plaintiff would be 550,000 shares, divided into 100,000 shares of Preferred Stock with a par value of $100

per share, and 450,000 shares of Common Stock with a par value of $20 per share. Immediately prior to said amendment, plaintiff's Certificate of Organization provided for the issuance of 450,000 shares of Common Stock with a par value of $20 per share, 50,000 shares of Preferred Stock with a par value of $100 per share and 50,000 shares of $6 Preferred Stock with no par value.

13. Prior to and during the period from June 23, 1944 to August 1, 1944, the by-laws of plaintiff provided that the $6 and 7% Preferred Stocks were redeemable upon any dividend date at $110 per share.

14. Under the Plan adopted by its stockholders on June 23, 1944, to redeem and replace its 7% and $6 Preferred Stocks, plaintiff, on June 30, 1944, offered to the holders of such old Preferred Stock a right to exchange their old Preferred Stock for new 4% Preferred Stock of the plaintiff on the basis of one share of old Preferred Stock for one share of new Preferred Stock, plus accumulated dividends payable on August 1, 1944 plus a cash payment of $8 per share. Under said plan, all old Preferred Stock not exchanged pursuant to said plan by July 22, 1944 was to be redeemed at the rate of $110 per share plus the final quarterly dividend which was payable on August 1, 1944.

15. Effective August 1, 1944, new by-laws of plaintiff were adopted. Among other things, call prices for the new preferred stock varying from $104 to $106, depending upon the date of redemption were established. Also a provision was included in said by-laws prohibiting the issuance of new preferred stock in excess of 60,587 shares without the affirmative vote of a majority of the voting

power of the outstanding new preferred stock, unless the earnings of plaintiff for any twelve consecutive months within the fifteen calendar months next preceding any such proposed transaction equaled 1¾ times annual interest and preferred dividend requirements.

16. Pursuant to the Plan described in finding 14 above and prior to July 23, 1944, holders of 20,354 shares of the $6 Preferred Stock and holders of 19,233 shares of the 7% Preferred Stock accepted the offer made under the Plan and pursuant thereto, in 1944, 39,587 shares of 4% Preferred Stock were issued to the old shareholders, together with a cash payment on the basis of $8 per share in an aggregate amount of $316,696, which amount was charged on the books of the plaintiff to earned surplus. This cash payment was in addition to the amount paid to these same stockholders as their regular quarterly dividend in the total amount of $64,188.75.

17. Holders of 21,000 shares of the old Preferred Stock did not exchange said shares for the new 4% Preferred Stock of Plaintiff and in accordance with the Plan said old Preferred shares were redeemed, on August 1, 1944, at $110 per share, by an aggregate payment to the holders thereof of $2,310,000; $10 per share of the $110 per share redemption price represented call premium. Accordingly, a premium of $210,000 was paid by plaintiff in connection with the redemption of its old Preferred Stock. The premium paid was in addition to the amount paid to these same stockholders as their regular quarterly dividend in the total amount of $34,724.25.

18. The premium paid by Idaho Power Company in connection with the redemption of its 7% and $6 Pre-

ferred Stock in the amount of $210,000 was charged to earned surplus on the books of Idaho Power Company.

19. The total capital paid in in respect of the issuance of each share of the 28,457 shares of $6 Preferred Stock and 32,130 shares of 7% Preferred Stock which were exchanged or redeemed as described in findings 16 and 17 hereof, was in the amount of $100 per share.

20. The face of the certificate of stock representing the 7% Preferred Stock of Idaho Power Company contains the following statement:

> "This Certifies that _____ is the owner of _____ full-paid and non-assessable shares of THE PAR VALUE OF $100 EACH OF THE PREFERRED STOCK (7%) of Idaho Power Company, transferable on the books of the Corporation by the holder in person or by duly authorized attorney upon surrender of this Certificate properly endorsed. The Preferred Stock, pari passu, with the $6 Preferred Stock, is entitled in preference to the Second Preferred Stock and the Common Stock to cumulative dividends at the rate of 7% per annum and in any distribution of assets, other than profits, to the payment of the full par value thereof and accumulated dividends; the $6 Preferred Stock, pari passu with the Preferred Stock, is entitled in preference to the Second Preferred Stock and the Common Stock to cumulative dividends at the rate of $6 per share per annum and in any distribution of assets, other than profits, to the payment of $100 per share and accumulated dividends; subject to the rights of the holders of Preferred Stock and $6 Preferred Stock and in subordination thereto the Second Preferred Stock shall be entitled in preference to the Common Stock to non-cumulative

dividends at the rate of 7% per annum and in any distribution of assets, other than profits, to the payment of the full par value thereof; the Common Stock is entitled to all other dividends and distributions; upon vote of a majority in interest of the Common Stock, either the Preferred Stock, $6 Preferred Stock or Second Preferred Stock, or all thereof, are subject to redemption upon any dividend date at 110% of par, $110 per share and at par, respectively, plus, in the case of Preferred Stock, accumulated dividends, on thirty (30) days' notice by mail; all as more fully provided in the amended Certificate of Organization and the amended By-Laws of the Corporation, a copy of each of which is on file with the Transfer Agent. The Preferred Stock, the $6 Preferred Stock, the Second Preferred Stock and the Common Stock are issued subject to all the provisions of the amended Certificate of Organization and the amended By-Laws of the Corporation and the holder hereof agrees to said provisions by the acceptance of this Certificate. Certain of said provisions, including those above referred to, are endorsed hereon. This Certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar."

21. The face of the certificate of stock representing the $6 Preferred Stock of Idaho Power Company contains the same statement as set forth in finding 20 in respect of the 7% Preferred Stock except that in lieu of the words "OF THE PAR VALUE OF $100 EACH OF THE PREFERRED STOCK (7%)" appear the words "WITHOUT A PAR OR FACE VALUE OF THE $6 PREFERRED STOCK".

22. Meetings of Directors and Stockholders of plaintiff were held during April, May, June and July of 1944

at which action was taken in respect of the redemption and replacement of plaintiff's 7% and $6 Preferred Stock and related matters.

23. Various documents were transmitted to plaintiff's stockholders in connection with the redemption and replacement of plaintiff's 7% and $6 Preferred Stock among which were the following:

Letter to Stockholders dated May 22, 1944

Notice of Call, Redemption and Payment of All Issued and Outstanding 7% and $6 Preferred Stock of Idaho Power Company dated June 30, 1944

Form transmitting 7% and $6 Preferred Stock Redemption Checks

Form transmitting 7% and $6 Preferred Stock exchange checks

Form of acknowledgment by Idaho Power Company of receipt of Preferred Stock Certificates

24. At the beginning of 1944, plaintiff had accumulated earnings and profits of $190,297.02. Additions to earnings and profits during the year 1944, before reduction on account of plaintiff's 1944 Federal income and excess profits taxes and State of Idaho income tax, were $1,961,646.92, so that at the end of the year plaintiff's accumulated earnings and profits before Federal and State income and profits taxes amounted to $2,151,943.94.

25. The amount of additions to earnings and profits of plaintiff during the year 1944 after reduction on account of plaintiff's 1944 Federal income and excess profits taxes and State of Idaho income tax but before giving effect to any allowance under plaintiff's claim was $1,043,778.30. If plaintiff's claim is allowed in whole or in part due

effect must be given in determination of the amount of additions to earnings and profits of plaintiff during the year 1944 to the recomputation of plaintiff's 1944 Federal income and excess profits tax and State of Idaho income tax liabilities as stated in findings 26 and 27 hereof.

26. In the computation of plaintiff's State of Idaho income tax liability for the calendar year 1944, the amount of plaintiff's Federal income and excess profits tax liability for the calendar year 1944 is applied as a deduction from gross income in computing net income subject to said tax; and if plaintiff's claim is allowed in whole or in part the fact as stipulated in this finding must be taken into account in recomputation of plaintiff's income and excess profits tax liability under Rule 38 of this Court.

27. In the computation of plaintiff's Federal income and excess profits tax liability for the calendar year 1944, the amount of plaintiff's State of Idaho income tax liability for the calendar year 1944 is applied as a deduction from gross income in computing net income subject to said tax; and if plaintiff's claim is allowed in whole or in part the fact as stipulated in this finding must be taken into account in recomputation of plaintiff's income and excess profits tax liability under Rule 38 of this Court.

28. During the year 1944 plaintiff made the following cash distributions to its preferred and common stockholders:

Appendix A

Distribution	*Payment date*	*Amount*
Regular preferred dividend on 7% and $6 Preferred Stocks.	Feb. 1	$ 98,913.00
Regular dividend on Common Stock.	Feb. 21	180,000.00
Regular preferred dividend on 7% and $6 Preferred Stocks.	May 1	98,913.00
Regular dividend on Common Stock.	May 20	180,000.00
Regular preferred dividend on 7% and $6 Preferred Stocks.	Aug. 1	98,913.00
Cash payment of $8 per share paid on exchange of 39,587 shares of 7% and $6 Preferred Stocks.	Aug. 1	316,696.00
Call premium of $10 per share paid on redemption of 21,000 shares of 7% and $6 Preferred Stocks.	Aug. 1	210,000.00
Regular dividend on Common Stock.	Aug. 21	180,000.00
Regular dividend on 4% Preferred Stock.	Nov. 1	60,587.00
Regular dividend on Common Stock.	Nov. 21	180,000.00
Total distribution to stockholders.		$1,604,022.00

29. In its Federal income tax return for the year 1944, plaintiff did not claim or receive any dividends paid credit under Section 26 (h) of the Internal Revenue Code of 1939 for the aforesaid cash distribution of $316,696 paid August 1 to the stockholders who exchanged their stock or for the amount of $210,000 call premium paid August 1 to the stockholders who redeemed their stock.

30. The following statements appear in the Protest dated June 9, 1949 sworn to by an officer of plaintiff and

filed by plaintiff with the Internal Revenue Agent in Charge, Salt Lake Division, at page 4:

> "The offer further provided that such $6 and 7% Preferred shares that were not offered for exchange before the exchange period expired would be retired by appropriate call and by a cash payment to the shareholders of $110 per share".

At page 5:

> "Following the exchange the remaining outstanding preferred shares were redeemed at the rate of $110 per share for a total consideration of $2,310,000".

31. The following statement appears on pages 22 and 23 of the "Supplemental Protest to Proposed Rejection of Claim for Refund" dated January 12, 1951 and filed by counsel for plaintiff with the Technical Staff Northwestern Division:

> "In this connection reference is made to the protest heretofore filed wherein it was pointed out that, as part of the 1944 recapitalization, the taxpayer redeemed all of its outstanding $6 and 7% Preferred Stock that was not exchanged under the exchange offer at the rate of $110 per share for a total consideration of $2,310,000. The number of shares so redeemed was 21,000 and $10 out of the $110 redemption price represented call premium. Accordingly, a premium of $210,000 was paid in connection with this redemption. Under the decision in *Commissioner* v. *Estate of Bedford*, as applied by the decision of the Court of Appeals for the Second Circuit in *Kirschenbaum* v. *Commissioner* (supra), it would appear that such premium constituted a taxable dividend and that the taxpayer is entitled to a credit therefor under Code Section 26 (h) in addition to the credit claimed for the $316,696 distributed to the

exchanging Preferred shareholders. However, at this time the taxpayer does not intend to urge vigorously that it is entitled to such additional credit and makes reference thereto only for the purpose of noting the point and the further purpose of pointing out how well imbedded in the law has become the doctrine as here contended in support of its refund claim".

32. The following statement appears on pages 34 and 35 of the "Supporting Statement to Appellate Staff Memorandum" dated February 19, 1953 in which it was determined that plaintiff's claim for refund referred to hereinabove in finding 10 should be rejected:

"Considering now the nature of the distribution of $316,696.00, it may be noted somewhat parenthetically that in addition to the payment of that amount to stockholders who took advantage of the opportunity of exchanging their old preferred shares for new stock, the taxpayer paid the sum of $210,000.00 as a premium to the nonexchanging holders of 21,000 shares who elected to surrender their stock to the corporation at the redemption price of $110.00 per share. The taxpayer maintains that under the reasoning of certain cases on which it leans and which will be hereinafter referred to, since the sum of $372,856.26 remained available for 'dividends' under its theory, it may be reasoned that this sum of $210,000.00, as well as the sum of $316,696.00, constituted a distribution taxable as a dividend and that it is entitled to a credit therefor under section 26 (h) of the Code in addition to the credit claimed for the $316,696.00 distributed to the exchanging shareholders. In the brief submitted to the Appellate Division under date of January 12, 1951, however, the taxpayer states that its position with respect to the additional sum of $210,000.00 is that it 'does not intend to urge vigorously that

it is entitled to such additional credit and [that it] makes reference thereto only for the purpose of pointing out how well embedded in the law has become the doctrine as here contended in support of its refund claim'".

33. In a letter dated February 19, 1953 from the Assistant District Commissioner, Appellate, plaintiff was informed that careful consideration had been given to the statements made in the claim for refund, to the protest dated June 10, 1949 (referred to in finding 30 above as dated June 9, 1949) and to the supplemental protest referred to in finding 31 above.

34. During August 1943 Electric Power & Light Corporation as the holder of all of the 150,000 outstanding shares of the Common Stock of Idaho Power Company of a par value of $100 per share and 2,670 shares of the 7% Cumulative Preferred Stock of that Company of a par value of $100 per share surrendered to Idaho Power Company 60,000 shares of such Common Stock and 2,670 shares of such Preferred Stock.

35. Journal Voucher No. 175 recorded on the books of Idaho Power Company the surrender of the shares of stock of Idaho Power Company by Electric Power & Light Corporation.

36. Journal Voucher No. 176 recorded on the books of Idaho Power Company the disposition of the capital surplus account created as shown by Journal Voucher No. 175.

37. The findings and opinions of the Securities and Exchange Commission as found at pages 848 to 853, inclusive, of Volume 13 of the Securities and Exchange Commission Decisions and Reports, relate to said surrender of

shares of Idaho Power Company stock by Electric Power & Light Corporation.

38. The tax cost base of the 60,000 shares of Common Stock and 2,670 shares of Preferred Stock of Idaho Power Company in the hands of Electric Power & Light Corporation immediately prior to surrender thereof by that Corporation to Idaho Power Company was:

2,670 Shares of Preferred Stock	$ 256,740.00
60,000 Shares of Common Stock	$3,610,898.58

39. Electric Power & Light Corporation on September 3, 1943 sold 450,000 shares of Idaho Power Company Common Stock to Blyth & Company Inc. and Lazard Freres & Company, both of New York City, for a cash consideration of $10,361,250. Said 450,000 shares of the Common Stock of Idaho Power Company had been received by Electric Power & Light Corporation shortly before the sale thereof in exchange for surrender to Idaho Power Company of the 90,000 shares of $100 par value of Idaho Power Company Common Stock previously held by Electric Power & Light Corporation.

40. The tax base balance sheet of Idaho Power Company as of July 31, 1916 shows that the 7% Cumulative Preferred Stock had a then book value of $100 par value per share and the 150,000 shares of Common Stock of a par value of $100 per share had a then aggregate book value of $7,207,620.96.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition is therefore dismissed.

Appendix B

Decision of The United States Court of Claims and Opinion of Madden, J., in *Atlantic City Electric Co.* v. *United States.*

In the United States Court of Claims

No. 33-55

(Decided May 7, 1958)

ATLANTIC CITY ELECTRIC COMPANY v. THE UNITED STATES

OPINION

MADDEN, *Judge*, delivered the opinion of the court:

The plaintiff sues for $84,105.60 of income tax paid by it for the year 1944. It claims that it should not have had to pay this tax because it was entitled to a credit which would have reduced its taxable income.

Section 26 (h) of the Internal Revenue Code of 1939 provided that a public utility corporation, in computing its surtax net income, was entitled to a credit for, i.e., a deduction of, "the amount of dividends paid during the taxable year on its preferred stock." The plaintiff was a public utility, and the stock in question qualified in all respects for the benefits of section 26 (h). The question is whether the payments made by the plaintiff during 1944 were "dividends" within the meaning of section 26 (h).

In *Public Service Electric and Gas Co.* v. *United States*, No. 318-56, — C. Cls. —, decided January 15, 1958, this court discussed the reason for the enactment by Congress of section 26 (h). It there appears that Congress desired

to give to public utility companies which had financed themselves by issuing preferred stock a status, for tax purposes, similar to that of such corporations which had financed themselves by issuing bonds. Since the interest on the bonds was deductible, dividends on preferred stock were made deductible.

The payments which the plaintiff made to its stockholders, and sought to deduct from its taxable income, were not the payments of $6 per share which accrued annually on its preferred stock and which, under the terms of that stock, had to be paid before the common stockholders could be paid any dividends. The payments here in question were payments of $20 per share, in addition to the $100 par value of the preferred shares, for the redemption of the stock. The preferred stock as issued provided that the plaintiff corporation could, at its option, redeem the shares for $120 plus accrued dividends, and the plaintiff did so redeem them. The accrued dividends so paid were clearly deductible under the provisions of section 26 (h), and they are not involved in this case. The redemption payments of $20 per share are the payments in question. As we have said, the question is whether they were "dividends" within the meaning of section 26 (h).

To the layman, a payment to a shareholder of a sum in addition to the regular dividends provided for in his stock certificate, a sum which would never be paid again because it was paid for the redemption and cancellation of the stock, would not be regarded as a dividend. But the meaning of a word in the tax statutes is not a question for a layman, unless the by no means impossible situation occurs when, as a last resort, refuge is taken in the lay meaning.

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Since section 26 (h) merely uses the word "dividend" without definition, one must look elsewhere in the statutes to learn whether it applies to the instant situation in which the payment was not obviously a dividend. The plaintiff points to section 115 (a) of the Internal Revenue Code of 1939 for the definition of "dividend" for the instant purpose. That section says:

> The term "dividend" * * * means any distribution made by a corporation to its shareholders * * * out of its earnings or profits * * *.

The $20 per share payment in question was made out of accumulated earnings of the plaintiff. Therefore, the plaintiff says, it was by definition a dividend and was covered by the language of section 26 (h).

The Government says that before one reaches a conclusion as to the effect of the broad definition of dividend in section 115 (a), one must look at section 115 (c), which provides for "Distributions in liquidation" and says:

> Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation * * * as in part or full payment in exchange for the stock.

The payments of the $120 per share for the redemption of the $100 par value stock liquidated the stock. According to section 115 (c), the entire $120 was taxable to the stockholder who received it, if it was taxable at all, only to the extent that the $120 represented a capital gain to the distributee-shareholder, and was taxable only at capital gains rates. It might well have involved no capital gain to him

at all, as, for example, if he had paid $120 per share for the stock.

The Government says that section 115 (c), in saying that amounts distributed in liquidation shall be treated as "payment in exchange for the stock," not only means that they shall be so treated in the hands of the distributee-shareholder, but that they shall be so treated as regards the distributor-corporation. If they are so treated, the corporation has, for tax law purposes, not distributed a dividend, but bought a share of stock. That would not entitle it to any deduction under section 26 (h).

The Government urges that it would be an illogical and asymmetrical reading of section 115 (c) to regard it as applying only to the distributee-shareholder side of the redemption transaction, and not to the distributor-corporation side. There would, however, have been a valid reason for the distinction, if Congress chose to make the distinction. From the corporation's side, the money distributed was earnings which had accumulated in its treasury. As we have suggested above, to the distributee-shareholder it may not have represented any profit at all. He may well have, in the money market of those times, regarded a 6 percent preferred stock redeemable at $120 as worth $120, or $110, and have paid that much for it, so that the $20 was not, or was not all, profit or other income. A similar situation might occur with regard to unpaid cumulative preferred stock dividends which were finally paid, as dividends, but for most of which the shareholder had already paid when he purchased the stock in the market. Section 115 (c) would not take care of such a taxpayer. Whether any other provision of law would help him we do not know.

Appendix B

We are not persuaded, then, by the Government's argument for symmetry in the interpretation of section 115 (c). We think it is fair for the plaintiff to urge that the definition in section 115 (a) covers its case, and is not negatived by section 115 (c).

The plaintiff points to another provision which is in the third sentence of section 115 (c) and which says:

> In the case of amounts distributed * * * in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

The plaintiff says that this sentence contains a negative inference that the part of a distribution in partial liquidation which *is* properly chargeable to earnings, and hence not "properly chargeable to capital account" is a distribution of earnings and is therefore a dividend, within the definition of section 115 (a). The statement in the sentence quoted above is a statement of the obvious. The Government says it was inserted to clarify the question whether, when a corporation had earnings accumulated prior to 1913, and redeemed a part of its stock at prices which took into account the value created by the pre-1913 earnings, and later distributed a dividend, the distributee could claim that the earlier distribution exhausted the post-1913 earnings and hence the later distribution was from the pre-1913 earnings and was tax free. In fact, in an earlier version of this sentence of section 115 (c), *viz.* section 201 (c) of the Revenue Act of 1924, 43 Stat. 253, it expressly said that distributions properly chargeable to capital account should not be considered as distributions of earnings or profits "for the purpose of determining the taxability of subsequent distributions by

the corporation." The Revenue Act of 1936, 49 Stat. 1648, dropped the limiting language just quoted, but Congress gave no reason for dropping it.

Our consideration up to this point shows a definition in section 115 (a) which would make the plaintiff's distribution a "dividend" for all purposes, including the purpose of the section 26 (h) deduction, and a miscellany of provisions in section 115 (c) which qualify the definition given in 115 (a). The first sentence in 115 (c) says that distributions in liquidation, though they would be dividends within the definition of 115 (a), shall not be treated, for tax purposes, as dividends, but shall be treated as payments of purchase price of the liquidated stock. This sentence does not tell us whether these payments should be so treated as regards both the distributee-shareholder and the distributor-corporation or only as regards one of them. The second sentence of section 115 (c) which provides for determination and recognition of gain or loss is expressly applicable only to the distributee-shareholder. The third sentence could be applicable to both parties to the transaction, but the negative inference which it contains cannot have the effect of making the distributions of earnings taxable to the distributee as dividends, without contradicting the first and second sentences of the same section. The foregoing summary shows that the statutory situation is confused.

There have been other situations in which it has been advantageous to taxpayers to show that distributions made, or received, were dividends. We consider those situations for possible enlightenment on our problem.

Section 216 (a) of the Revenue Act of 1918, 40 Stat. 1057, 1069, allowed taxpayers a tax credit for the "amount

received as dividends from a corporation." In *Hellmich* v. *Hellman*, 276 U. S. 233, the taxpayer had received, in a distribution in liquidation of a corporation, moneys which had been accumulated as earnings of the corporation. He claimed the credit, pointing to the definition of dividends in section 115 (a), which was section 201 (a) of the Revenue Act of 1918. The Court held that he was not entitled to the credit, in spite of the 115 (a) definition of dividends because 115 (c), then 201 (c), expressly provided that the payments in liquidation should be treated as the purchase price of the liquidated stock. The Court said, at pages 236-237:

> It is true that if § 201 (a) stood alone its broad definition of the term "dividend" would apparently include distributions made to stockholders in the liquidation of a corporation—although this term, as generally understood and used, refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock. See *Lynch* v. *Hornby*, 247 U. S. 339, 344-346; and *Langstaff* v. *Lucas* (D. C.) 9 F. (2d) 691, 694.
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> However, when § 201 (a) and § 201 (c) are read together, under the long-established rule that the intention of the lawmaker is to be deduced from a view of every material part of the statute, *Kohlsaat* v. *Murphy*, 96 U. S. 153, 159, we think it clear that the general definition of a dividend in § 201 (a) was not intended to apply to distributions made to stockholders in the liquidation of a corporation, but that it was intended that such distributions should be governed by § 201 (c), which, dealing specifically with such liquidation, provided

that the amounts distributed should "be treated as payments in exchange for stock" and that any gain realized thereby should be taxed to the stockholders "as other gains or profits." This brings the two sections into entire harmony, and gives to each its natural meaning and due effect. The Treasury Regulations correctly interpreted the Act as making § 201 (a) applicable to a distribution made by a going corporation to its stockholders in the ordinary course of business, and § 201 (c) applicable to a distribution made to stockholders in liquidation of the corporation. And this is in accord with the rulings of the Board of Tax Appeals. *Appeal of Greenwood,* 1 B. T. A. 291, 295; *Appeal of Chandler,* 3 B. T. A. 146, 149.

The *Hellmich* case was, of course, concerned with the status of the distributed money in the hands of the distributee, as a dividend *vel non.* The Court's language, like the language of the statute, does not tell us whether the payment would have the nondividend status as regards the distributor-corporation, which is our problem in the instant case. The Treasury Regulation approved by the Court, Treasury Regulations 45 (1919 ed.) Art. 1548, is as broad as the statute and the Court's opinion. *Foster* v. *United States,* 303 U. S. 118, affirming 84 C. Cls. 193, was another case in which the status of the payment in the hands of the distributee-shareholder was involved, and the decision was that the broad definition of dividends in 115 (a) was overridden by the specific provisions of 115 (c).

The plaintiff says that the language of section 115 (c) and of the judicial opinions and of the executive regulations should be limited to the situation which, the plaintiff

says, all of the users of the language had in mind, *viz*, the status of the money in the hands of the distributee.

We now consider a comparable statutory situation in which the important question is the one involved in the instant case, *viz*, the status of the distribution from the standpoint of the distributing corporation. For the purpose of compelling the distribution of corporate profits so that they could be taxed in the hands of the shareholders, Congress in section 14 of the Revenue Act of 1936, *supra*, imposed a surtax on undistributed corporate profits. See *Reed Drug Co.* v. *Commissioner*, 130 F. 2d 288 (C. A. 6). In the section which became section 27 (g) of the Internal Revenue Code of 1939, Congress provided a credit against the undistributed profits taxes for that part of a distribution in liquidation which was properly chargeable to earnings and profits. The section provided that such a payment should be "treated as a taxable dividend paid."

The Government says that if the plaintiff is right in its claims as to the universality of the definition of dividend in section 115 (a) and the one-sidedness of the provision in the first sentence of section 115 (c), limiting its capital gains treatment to the funds in the hands of the distributee, there would have been no reason for the insertion of section 27 (g). It says that, under the plaintiff's assumptions, the payments described in section 27 (g) would of course have been dividends and would have been covered by the general language giving credit for dividends paid, without any need for being specially "treated as a taxable dividend paid." We think there is force in the Government's argument. We wish Congress had been equally specific and clear in its writing of section 26 (h), with which we are here concerned.

In *Helvering* v. *Credit Alliance Corp.*, 316 U. S. 107, the corporation had distributed accumulated earnings in a

liquidation transaction and claimed the statutory credit for dividends paid. The Court said, at page 110:

> Although a distribution in liquidation of earnings * * * does not constitute a dividend in the proper sense of the term,[1] subsection (f)[2] categorically declares that a liquidating distribution, to the extent it is composed of such earnings, shall, for the purposes of computing the dividends-paid credit *"be treated as a taxable dividend paid."*

In *St. Louis Co.* v. *United States*, 237 F. 2d 151 (C. A. 3), *cert.* den. 352 U. S. 1001, the corporation taxpayer claimed a dividends-paid credit for payments made in a distribution in liquidation. It had a deficit balance of accumulated earnings, but it had current earnings in the year of distribution. Under the definition of dividends in section 115 (a) and the provisions of section 115 (b), applied without consideration of section 115 (c), its contention would have been right. But the Court held that the statutes made a distinction between distributions made by a going corporation and those made by a corporation in liquidation; that in the latter case the distributions in liquidation would be treated as dividends only if a statute such as section 27 (g) specifically so provided, and that the taxpayer's situation did not comply with section 27 (g) because it did not have accumulated earnings, but a deficit. In *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. 2d 177 (C. A. 7), the court gave similar treatment to a comparable situation.

Another instance of a "dividends paid" credit in the statutes is a section of a 1935 Act, 49 Stat. 908, which became section 121 of the Internal Revenue Code of 1939,

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[1] The Court here cited *Hellmich* v. *Hellman*, *supra*.
[2] Section 27 (g) of the Internal Revenue Code of 1939.

which gave to banks and domestic insurance companies a tax deduction for dividends paid on their preferred stock. The Secretary of the Treasury suggested that the bare language in the draft of the bill "any dividend paid" should be qualified by the parenthetical expression "(not including any distribution in liquidation)" and that change was made. It is fair to urge that the change was made because the general language "any dividend paid" would have, without the qualification, included distributions made in liquidation, according to the definition of dividends in section 115 (a).

The plaintiff urges that the purpose of Congress in providing the tax credit to public utility corporations for dividends paid on preferred stock will be, in part, frustrated if they are not allowed such credit for distributions in liquidation. It should be said that there is no evidence whatever that Congress put its mind on the particular question here involved. The plaintiff's argument is that the purpose of Congress was to give to public utility corporations which had financed themselves by issuing preferred stock the same tax status as those which had financed themselves by issuing bonds. The only payments discussed by the witnesses who spoke for 26 (h) were the regularly recurring, cumulative, charges in the form of dividends on preferred stock which corporations which so financed themselves had to pay. The more esoteric questions of tax treatment of the issuance of bonds at a premium or at a discount, or their redemption at a premium or at a discount, and how similar tax treatment of preferred stock so issued or so redeemed could be provided for, were not raised. If they had been, they might well have confused the principal objective of the legislation, which was to get the tax credit for the normal

recurring payments which all persons would recognize as dividends.

We get no real help from a consideration of the purpose of the legislation. We are obliged to conclude that Congress meant by the word dividends in section 26 (h) whatever meaning the applicable statutes gave to the word in its proper context. We are, therefore, thrown back upon section 115 and its several subsections. As our discussion has indicated, section 115, and other legislation relating to analogous situations, give rise to conflicting inferences.

Our instant problem has not been decided by any court. The Supreme Court of the United States, and other courts which have adjudicated related problems, have said in effect that the general definition of dividends in section 115 (a) is not applicable to distributions in liquidation; that to whatever extent they are to be treated as dividends, the justification must be found in section 115 (c) or elsewhere. We recognize that most, perhaps all, of such decisions coud have been reached without the use of language as inclusive as that used by the courts. We cannot, however, ignore these expressions of opinion.

The question being so evenly balanced, on the basis of the text of the statutes and the logical inferences to be drawn from them, we are persuaded by the expressions of the other courts to the conclusion that the distribution here in question was not a dividend within the meaning of section 26 (h).

The plaintiff's petition will be dismissed.

It is so ordered.

LARAMORE, *Judge;* WHITAKER, *Judge;* LITTLETON, *Judge;* and JONES, *Chief Judge,* concur.

(The Findings of Fact of the Court of Claims in *Atlantic City Electric Company* v. *United States* have been omitted).

Appendix C

Statutes Involved

Internal Revenue Code of 1939:

SEC. 26. CREDITS OF CORPORATIONS

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * * * *

(h) CREDIT FOR DIVIDENDS PAID ON CERTAIN PREFERRED STOCK.—

(1) AMOUNT OF CREDIT.—In the case of a public utility, the amount of dividends paid during the taxable year on its preferred stock. For the purposes of the credit provided in this subsection the amount of dividends paid shall not include any amount distributed in the current taxable year with respect to dividends unpaid and accumulated in any taxable year ending prior to October 1, 1942. Amounts distributed in the current taxable year with respect to dividends unpaid and accumulated for a prior taxable year shall for the purposes of this paragraph be deemed to be distributed with respect to the earliest year or years for which there are dividends unpaid and accumulated. The credit provided in this subsection shall be subtracted from the basic surtax credit provided in section 27.

(2) DEFINITIONS.—As used in this subsection and section 15(a)—

(A) Public Utility.—The term "public utility" means a corporation engaged in the furnishing of telephone service or in the sale of electric energy, gas, or water, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision there-

of or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

(B) Preferred Stock.—The term "preferred stock" means stock issued prior to October 1, 1942, which during the whole of the taxable year (or the part of the taxable year after its issue) was stock the dividends in respect of which were cumulative, limited to the same amount, and payable in preference to the payment of dividends on other stock. Stock issued on or after October 1, 1942, shall be deemed for the purposes of this paragraph to have been issued prior to October 1, 1942, if it was issued (including issuance either by the same or another corporation in a transaction which is a reorganization, as defined in section 112(g)(1); or a transaction to which section 112(b)(10), or so much of section 112(d) or (e) as relates to section 112(b)(10), is applicable, or which is a transaction subject to Supplement R) to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace other preferred stock (including stock which is preferred stock by reason of this sentence), but only to the extent that the par or stated value of the new stock does not exceed the par, stated, or face value of the bonds or debentures issued prior to October 1, 1942, or the other preferred stock, which such new stock is issued to refund or replace. The determination of whether stock was issued to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace other preferred stock, shall be made under regulations

prescribed by the Commissioner with the approval of the Secretary.

(26 U.S.C. 1940 ed., Supp. IV, Sec. 26)

Sec. 27. Corporation Dividends Paid Credit . . . .

(g) Distributions in Liquidation.—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings of profits accumulated after February 28, 1913, shall, for the purposes of computing the basic surtax credit under this section, be treated as a taxable dividend paid. . . . (26 U.S.C. 1940 ed., Sec. 27.)

Sec. 112. Recognition of Gain or Loss

. . . . . .

(c) Gain from Exchanges Not Solely in Kind.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph

(1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

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(26 U.S.C. 1940 ed., Supp. IV, Sec. 112)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS

(a) Definition of Dividend—The term "dividend" when used in this chapter (except in section 201(c)(5), section 204(c)(11) and section 207(a)(2) and (b)(3) (where the reference is to dividends of insurance companies paid to policyholders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year, (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. Such term also means any distribution (to the extent of its subchapter A net income, whether or not a dividend as defined in the preceding sentence) to its shareholders, whether in money or in other property, made by a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company, or which, for the taxable year in respect of which the distribution is made under section 504(c) or section 506 or a corresponding provision of a prior income tax law, is a personal

holding company under the law applicable to such taxable year.

* * * * *

(c) Distributions in Liquidation—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributees resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. If any distribution in partial liquidation or in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) is made by a foreign corporation which with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding company, and with respect to which a United States group (as defined in section 331(a)(2) existed after August 26, 1937, and before January 1, 1938, then, despite the foregoing provisions of this subsection, the gain recognized resulting from such distribution shall be considered as a gain from the sale or exchange of a capital asset held for not more than 6 months.

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Appendix C

(i) Definition of Partial Liquidation—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

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(26 U.S.C. 1940 ed., Supp. IV, Sec. 115)